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**INSURANCE POLICY CANCELLATION AND NONRENEWAL IN MARYLAND - STATUTORY RELAXATION
OF THE "STANDARDS CLAUSE"**

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In Maryland, an insurer's ability to cancel or fail to renew a motor vehicle liability policy has been described as "statutorily strait jacketed."¹ Similarly, statutory and judicial restrictions impact the ability of insurers to terminate policies of homeowners' insurance and other types of personal and commercial lines property and casualty insurance.² As a result of these restrictions, an insurer may not cancel or fail to renew the liability policy of an insured simply because the insured has had accidents or losses which caused the insurer to pay sizable claims. Rather, the insurer is required by Maryland law to demonstrate that any cancellation or non-renewal decision is based on "standards which are reasonably related to the insurer's economic and business purposes."³ This statutory requirement, referred to as the "Standards Clause," has had a severe impact on the ability of insurers to terminate undesired policies.⁴

The Burden on the Insurer Under 27-501

Termination of insurance policies by insurers must be based on "standards which are reasonably related to the insurer's economic and business purposes." To fully understand this burden on insurers, it is useful to review the origins of the 27-501(a)(2) "Standards Clause" and the cases that have interpreted that provision.

The History of the Standards Clause. Prior to 1970, there were no statutory restrictions on an insurer's ability to cancel property and casualty insurance policies in Maryland.⁵ Spurred by complaints of insurance discrimination brought by the civil rights movement, the Maryland General Assembly added 234A to the Insurance Code (now recodified as Insurance Article, 27-501), prohibiting arbitrary underwriting decisions based on race, creed, color, religion, national origin or place of residency.⁶

In 1974, the General Assembly significantly tightened the law by adding language which became known as the "Standards Clause" to 234A(a), prohibiting discrimination that is not actuarially justifiable.⁷ The new language provided, in part, that:

[n]o insurer, agent or broker may cancel or refuse to underwrite or renew a particular insurance risk or class of risk except by the application of *standards which are reasonably related to the insurer's economic and business purposes.*⁸

The 1974 legislation also shifted the burden of persuasion to the insurer to demonstrate that the proposed cancellation or nonrenewal is justified under the standards so demonstrated.

The Standards Clause legislation that was enacted in 1974 had significantly different language than that proposed in the original bill.⁹ The original House Bill in 1974 provided that:

No insurer, agent, or broker may cancel or refuse to underwrite or renew a particular insurance risk or class of risk, except by the application of standards which may be

insurance risk or class or risk, except by the application of standards which may be demonstrated objectively to have a direct and substantial effect upon losses and expenses.¹⁰

The Senate replaced the last portion of the sentence, "may be demonstrated objectively to have a direct and substantial effect upon losses or expenses," with the less rigorous "reasonably related to the insurer's economic and business purposes" standard which became the current law.¹¹ However, the Senate, through an apparent oversight, failed to amend the preamble to the Bill, which stated in part that underwriting "standards and rules [must] be demonstrated objectively to measure the probability of a direct and substantial adverse effect upon losses and expenses of the insurer . . ."¹² This oversight was significant, the Committee noted, because the Court of Special Appeals later relied on this flawed preamble language in *Crumlish v. Insurance Comm'r*, 70 Md. App. 182, 520 A.2d 738 (1987), to increase the insurer's burden under the Standards Clause. Floor Report, HB 625, at 2.

The *Crumlish* Decision. Following the adoption of the Standards Clause, Maryland courts continued to tighten the constraints on the underwriting decisions of private passenger automobile insurers. In *Lumbermen's Mutual Casualty v. Insurance Comm'r*, 302 Md. 248, 487 A.2d. 271 (1982), the Court of Appeals held that an insurer could not refuse to renew a driver's policy based on the presence of certain underwriting factors (i.e. certain number of violations and/or accidents) if the insurer had an approved rating plan that provided for surcharges for drivers whose records matched those underwriting factors.

In *Crumlish*,¹³ the Court of Special Appeals outlined a three-part test to measure the statistical evidence presented by insurers to meet their burden under the Standards Clause of 234A(a). Under that test, an insurer must show:

- (1) There is a statistical basis for the supposition that a person with a driving record comparable to that of the insured is more likely to have a chargeable accident within the policy period than a person with a clean driving record;
- (2) The statistics thus relied upon are valid; and
- (3) Underwriting the unacceptable risk would adversely affect the insurer's losses and expenses in light of its approved rating plan.¹⁴

The three-prong test was based, in part, on the *Crumlish* Court's conclusion that the Court of Appeals in *Lumbermen's* had adopted the preamble of the 1974 legislation as the legislative history of 234A(a).¹⁵ The preamble stated that insurers' underwriting decisions must:

be made solely on the basis of a reasonable application to relevant facts of underwriting principles, standards and rules that can be demonstrated objectively to measure the probability of a direct and substantial adverse effect upon losses or expenses of the insurer *in light of the approved rating plan or plans of the insurer then in effect.* . . .¹⁶

The *Crumlish* decision was sharply criticized by insurers and members of the General Assembly. Among those critics were members of the House Economic Matters Committee. In the Committee's Floor Report on HB 625 during the 1988 Legislative Session, the Committee concluded that the *Crumlish* three-part standard was inconsistent with the text of 234A(a). Floor Report, HB 625, at 3. The Committee wrote:

[i]n fact, the court ignored the very plain language of the Code and by judicial fiat substituted the judgment of the General Assembly with its own inflexible and mechanical standard for insurance underwriting. The *Crumlish* standard in many ways reduces the Insurance Commissioner to nothing more than a statistician. While the collection of statistical evidence for underwriting automobile accidents the *Crumlish* court dealt with may be possible, there are some risks that simply don't lend themselves to statistical review.¹⁷

review.¹⁷

The Committee noted the Insurance Commissioner's concern that insurers would be forced to renew the policies for unreasonably high risk insureds, because they did not have sufficient statistics to meet the *Crumlish* standard. As an example, the Committee noted, an insurer may be forced under *Crumlish* to renew the policy of a driver who refused a Breathalyzer test because statistics do not exist to show that drivers who refuse Breathalyzer tests are greater risks.¹⁸

Exceptions to the *Crumlish* Decision. Maryland courts have retreated somewhat from *Crumlish* and have not required such a rigid statistical showing for all nonrenewal/cancellation decisions. In *Miller v. Insurance Comm'r*, 70 Md. App. 355, 521 A.2d 761 (1987), the Court of Special Appeals held that an insurer did not have to renew the malpractice insurance policy of a doctor who had made material misrepresentations in his insurance applications regarding disciplinary action against him. The Court found that material misrepresentations are a valid reason to cancel an insurance contract, despite the substantive requirements of 234A.¹⁹ The Court noted that:

We see nothing in either the legislative history or the judicial interpretations of 234A suggesting that it was ever intended to abrogate the general rule of the law of contracts that when a party is induced to enter into a contract by fraud or material misrepresentation, the contract is voidable against the party making the misrepresentation.²⁰

The Court of Special Appeals also noted that it did not read *Lumbermen's* as "authority for the proposition that an underwriting standard providing for cancellation of a policy obtained by material misrepresentations is not reasonably related to the insurer's economic and business purposes."²¹

In *Mirkin v. Medical Mutual*, 82 Md. App. 540, 572 A.2d 1126 (1990), the Court of Special Appeals rejected the argument of a physician whose coverage was canceled after he altered his medical records, that the insurer had to provide statistics to meet the *Crumlish* test. The Court wrote:

There are obviously some underwriting standards whose fairness cannot be demonstrated through statistics but are nonetheless 'reasonably related to the insurer's economic and business purposes.' The standards employed in this case and in *Miller, supra*, provide useful examples. Each of these underwriting standards reflects the insurer's reluctance to insure what it justifiably considers questionable risks. The fact that the suitability of these standards cannot be mathematically verified does not foreclose their being 'reasonably related to the insurer's economic and business purpose.' We do not read 234A as requiring insurers to utilize only those underwriting standards capable of statistical validation.²²

240L - The First Relaxation of *Crumlish*

In 1995, the General Assembly, responding to complaints from insurers about the difficulty of satisfying the *Crumlish* factors, enacted legislation to lessen the statistical burden on insurers imposed by that The legislation allows motor vehicle insurers to use underwriting standards not subject to statistical validation if:

(1) The standards are based on factors that adversely affect the losses or expenses of insurers; and

(i) The statistical validation is not available; or

(ii) The statistical validation is unduly burdensome to produce; or

(2) The standards relate to:

(i) The submission by the applicant or policyholder of a false or fraudulent claim or application or other action that would constitute a

fraudulent claim or application or other action that would constitute a violation of 233A of this article; or

(ii) The conviction of the insured of a crime that increases the hazard insured against.²⁴

Unfortunately, there were two problems with 240L as adopted.²⁵ First, the relief from the strict statistical validation standard of *Crumlish* only applied to motor vehicle liability insurance. Moreover, the Legislature chose not to give unlimited relief to insurers as the effective period of 240L was prescribed to end by abrogation on September 30, 1998, after a 3-year trial period. Thus, even with respect to motor vehicle liability insurance, the relief would be short-lived.²⁶

The 1998 Legislation

After renewed efforts by the insurance industry, the 1998 Session of the Maryland Legislature finally undertook a more useful revision of the cancellation and nonrenewal laws and particularly of the "Standards Clause." The result has been the adoption of two bills, HB 1356²⁷ and SB 766²⁸, which provide for various safe harbors which could be utilized by insurers writing homeowners' insurance and private passenger motor vehicle insurance and which would not require proof of statistical validity in order for insurers to meet the required burden of proof at hearings.²⁹ Unfortunately, the Legislature has decided that these bills, too, should be "tests" and, if they are not extended by future legislative action, they will both abrogate after a 3-year trial period on September 30, 2001. These companion bills, as finally enacted, are identical in all meaningful ways.³⁰

HB 1356 contains explicit underwriting requirements for cancellation or refusal of renewal of homeowners' insurance and private passenger motor vehicle insurance and general exemptions for commercial insurance and "unauthorized insurance." These provisions will greatly assist insurers in their efforts to meet or escape the Standards Clause burdens generated by the *Crumlish* decision. While there have been administrative and judicial challenges concerning the need for statistical validation of underwriting decisions in the arena of private passenger motor vehicle insurance, credible actuarial data did exist which could be utilized by insurers to attempt to comply with the statistical validation requirements of *Crumlish*. When dealing with other lines of insurance, such as homeowners' insurance, however, such statistical validation was not possible; and insurers were often deemed to have failed to meet their burden of proof at hearings due to such impossibility. The Maryland Legislature has dealt with this issue by setting up defined "safe harbors" which could be utilized by insurers in making underwriting decisions without the necessity for justifying such decisions through statistical validation.³¹

In the case of homeowners' insurance, HB 1356 precludes an insurer from terminating homeowners' insurance based on weather-related claims history unless there were three or more weather-related claims within the preceding 3-year period or unless it gave written notice to the insured concerning specific repairs needed to be made, which the insured failed to make and which, if made, would have prevented the loss for which a claim was made.³² The bill also provides that a homeowners' insurer need not provide statistical validation for exercising underwriting rules concerning (a) material misrepresentations in connection with applications, policies or presentation of a claim, (b) nonpayment of premiums, (c) a change in physical condition which results in increase in hazard which, if present and known to the insured prior to policy issuance, would have caused the insurer not to issue the policy and (d) conviction of arson within the preceding 5-year period or of a crime which directly increased the hazard insured against within the preceding 3-year period.³³ Subject to the provisions of 27-501(i), which deals with termination for weather-related claims, no statistical validation is necessary where an insured is terminated because of more than three claims in the preceding 3-year period.³⁴ In addition to the stated reasons for which cancellation is allowed without statistical validation, the Commissioner is allowed to approve other standards based on factors that adversely affect the losses or expenses of the insurer under its approved rating plan and for which statistical validation is unavailable or is unduly burdensome to produce.³⁵ Finally, the Commissioner may adopt regulations containing other standards which he finds to be reasonably related to the economic and business purposes of the insureds.³⁶

HB 1356 also includes safe harbors directed particularly towards writers of private passenger motor vehicle insurance. Insurers do not have to provide statistical validation for termination of a policy due to (a) material misrepresentation made by an insured in conjunction with an application, policy or presentation of a claim, (b) nonpayment of premium or (c) a situation where, within the preceding 2-year period, there has been a revocation or suspension of a driver's license or motor vehicle registration for reasons related to the driving record of the driver.³⁷ Additionally, a safe harbor for termination without

registration for reasons related to the driving record of the driver.³⁷ Additionally, a safe harbor for termination without statistical validation is provided where there were (a) two or more motor vehicle accidents or any combination of three or more accidents and moving violations within the preceding 3-year period for which the insured was at fault for the accidents or (b) three or more moving violations against the insured or a covered driver within the preceding 2-year period.³⁸ Looking at criminal convictions, insurers may cancel the motor vehicle liability insurance without regard to statistical validation where the named insured or a covered driver was convicted of driving while intoxicated or impaired by drugs; homicide, assault, reckless endangerment, or criminal negligence arising out of the operation of the motor vehicle; or using the motor vehicle to participate in a felony.³⁹ As with the case of homeowners' insurance, the Commissioner is also allowed to approve other standards based on factors that adversely affect the losses or expenses of the insurer under its approved rating plan and for which statistical validation is unavailable or is unduly burdensome to produce and to adopt regulations setting forth other standards that are found to be reasonably related to the insurer's economic and business purposes.⁴⁰

The Legislature has also recognized that there are several types of factual scenarios which could result in time consuming disputes between insurers and insureds in the context of policy terminations. In a preemptive manner, provisions have been included in HB 1356 which provide that homeowners' insurers need not produce statistical validation that excludes weather-related claims or that makes any distinction of non-weather-related claims in order to sustain the insurer's burden of persuasion with respect to a cancellation or refusal to renew for a reason that is not listed among those in the statutory safe harbor.⁴¹ Likewise, motor vehicle insurers are not required to produce statistical validation that excludes at fault accidents or makes any distinction between not at fault accidents and at fault accidents in order to sustain the insurer's burden of persuasion with respect to termination for a reason not statutorily noted for termination of motor vehicle insurance.⁴²

HB 1356 will also be welcomed by insurers writing commercial lines. Commercial insurers are specifically excluded from any requirement to produce statistical validation of underwriting standards to meet their burden of persuasion under 27-501. A similar exemption is provided for non-admitted insurers.⁴³

Another problem cured by HB 1356 relates to disparate treatment of insureds by insurers seeking to terminate policies. Heretofore the Maryland Insurance Administration has enforced a "zero tolerance" policy for deviations from strict underwriting rules and has not allowed the consideration of mitigating factors to distinguish between two otherwise similarly situated insureds with respect to underwriting decisions regarding cancellation or nonrenewal. The new legislation allows consideration of specific mitigating factors without the necessity for an insurer to provide statistical validation. Those factors include the severity of the losses, the length of time that an insured has been a policyholder with the insurer, loss mitigation of previous losses, and the availability of a higher deductible for the particular policy and types of losses.⁴⁴

There is also a pitfall for insurers in the legislation. If an insurer considers claims history for purposes of canceling or refusing to renew coverage, the insurer shall disclose the practice to an insured at the inception of the policy and at each renewal.⁴⁵ Presumably this disclosure will not be difficult to make. It is a new requirement, however, and potentially will trap many insurers at least once.

Conclusion

The enactment of HB 1356 has been a significant step by the Maryland Legislature, and one which should help insurers in their efforts to perform underwriting activities in an efficient and economical basis. By removing the requirement of the *Crumlish* type statistical validation from underwriting decisions, insurers will not get caught in a morass of actuarial testimony at hearings involving cancellation or nonrenewal of policies. Likewise, the effort to remove issues, such as whether a homeowners' claim was weather-related or non-weather-related or whether a motor vehicle accident was at fault or not at fault, will make justification of underwriting decisions much simpler and more straightforward. At the same time, the designated safe harbors will give insureds some comfort concerning their ability to retain their insurance coverage in the face of legitimate claims made upon their policies. Since this legislation is only effective for a 3-year period, beginning on October 1, 1998, the relief afforded to insurers may disappear. Hopefully, the Maryland Legislature will find that this 3-year test is successful and will adopt these provisions on a more permanent basis.

Endnotes

1. See Andrew Janquitto, Maryland Motor Vehicle Insurance, 13.1, at 505 (1992).
2. The focus of this paper will be the termination of individual policies of insurance by the insurer. Maryland also regulates withdrawal of an insurer from a line of business, but such activity is beyond the scope of this paper. See Md. Code, Insurance Article, 27-603.
3. See Md. Ann. Code, Insurance Article, 27-501(a)(2). Insurance Article, 27-501 was formerly codified as Insurance Code, 234A. The new Insurance Article became effective on October 1, 1997, and replaced Md. Code, Article 48A (the Insurance Code) in its entirety.
4. While the provisions of 27-501 apply to all types of insurance, most of the applicable case law interpreting this area concerns "policies of motor vehicle liability insurance issued in Maryland as to any resident of the household of the named insured." (This rather awkward phrasing is intended to refer to private passenger motor vehicle liability insurance.)
5. See *GEICO v. Insurance Comm'r*, 273 Md. 467, 478, 330 A.2d 653 (1975). The Court in *GEICO* noted: "In the absence of statute, it is purely voluntary on the part of the company as to whom it will insure, and it is under no duty to write insurance for any particular applicant. The insurer is at liberty to chose its own risks and may accept or reject applicants as it sees fit." *Id.* at 478.
6. See 1970 Md. Laws, ch. 417.
7. See 1974 Md. Laws, ch. 752.
8. *Id.* (emphasis added).
9. See House Economic Matters Committee, Floor Report, HB. 625, Gen Assembl;y of 1988, 15 1-4 (1988) (hereinafter "Floor Report, HB. 625") (contains detailed discussion of the legislative history of the 1974 Standards Clause legislation). Although HB 625 was not passed during the 1988 Session, the legislative history summary of the 1974 legislation in Floor Report, HB 625 is instructive and sheds light on why the Standards Clause differs from the preamble of the 1974 legislation.
10. *Id.* at 1-4.
11. Floor Report, HB. 625, 15 1.
12. *Id.*
13. An often overlooked aspect of the *Crumlish* decision is that Court's discussion of the three-factor test was all *dicta*. The Court of Special Appeals remanded the case to the Insurance Commissioner to correct deficiencies in the Commissioner's order. *Crumlish*, 70 Md. App. at 188-89. Given this remand, it was not necessary for the Court to decide whether the insurer had met its statutory burden under 234A(a). However, the *Crumlish* court did address that question and outlined the three factors "for the guidance of the Insurance Commissioner" on remand. *Id.* at 189.
14. See *Crumlish*, 70 Md. App. at 190.
15. See *Crumlish*, 70 Md. App. at 189; quoting *Lumbermen's*, 302 Md. at 267.

16. *Lumbermen's*, 302 Md. at 267; quoting 1974 Md. Laws, ch. 752, preamble. (emphasis added by the *Lumbermen's* Court).

17. *Id.* at 3.

18. *Id.*

19. *Id.* at 369.

20. *Id.* at 368.

21. *Id.* at 370.

22. *Mirkin*, 82 Md. App. at 551.

23. See m1995 Md. Laws, ch. 352, codified as Md. Ann. Acoc. art. 48A, 240L (Supp. 1996).

24. Md. Ann. Code, art. 48A, 240L.

25. Section 240L was recodified as Insurance Article, 27-908.

26. As a result of the passage of HB 1356 and SB 766, discussed below, the Legislature did not extend the term of 240L.

27. HB 1356 has been enacted into law as ch. 652, Laws of Maryland, 1998. It amends Insurance Article, 27-501.

28. SB 766 has been enacted into law as ch. 651, Laws of Maryland, 1998. It too amends Insurance Article, 27-501.

29. 27-501(g) places the burden of persuasion on the insurer to show that the decision to cancel or to refuse to underwrite or renew is justified under the insurer's underwriting standards.

30. Since the bills are basically identical, further reference will only be made to HB 1356.

31. While the "safe harbors" have generally been phrased in a negative fashion in the legislation, their impact and certainty will be a positive and welcome relief for most insurers.

32. See, 27-501(i).

33. See, 27-501(j)(1).

34. See 27-501(j)(1)(v).

35. See 27-501(j)(1)(vi).

36. See 27-501(j)(1)(vii).

37. *See* 27-501(l)(1)(i), (ii) and (iii).

38. This aid to insurers should be compared with the somewhat ambiguous provisions of 27-501(k) which preclude an insurer from canceling an insured based on the insured's claims history where two or fewer of the claims within the preceding three year period were for accidents or losses for which the insured was not at fault for the loss. *See* 27-501(l)(1)(iv) and (v).

39. *See* 27-501(l)(1)(vi).

40. *See* 27-501(l)(1)(vii) and (viii).

41. *See* 27-501(j)(2).

42. *See* 27-501(l)(2).

43. Presumably non-admitted insurers are insurers doing business in Maryland on a surplus lines basis or are through non-admitted insurers which are not doing business in Maryland and which are approached by "industrial insureds" which go outside of Maryland to purchase coverage on their own behalf. *See* 27-501(m).

44. *See* 27-501(n)(2).

45. *See* 27-501(n)(2).